

**DEPARTMENT OF TRANSPORTATION**

AUDITS AND INVESTIGATIONS

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February 26, 2010

Jerry Way  
Director, Department of Transportation  
City of Sacramento  
915 I Street, Room 2000  
Sacramento, CA 95814-2604

Dear Mr. Way:

This letter is to inform you that the Indirect Cost Rate Proposals (ICRPs) submitted by the City of Sacramento's (City), Department of Transportation, Engineering Services and Traffic Engineering for fiscal years (FY) 2004/05, 2005/06, 2006/07, and 2007/08 are rejected due to lack of compliance with 2 Code of Federal Regulations (2 CFR), Part 225. The ICRPs contain fundamental errors that materially affect the rates. We previously attempted to audit the City's FY 2004/05 and 2005/06 ICRPs, but suspended that audit due to discrepancies with labor data and other issues. The results of the suspended audit were communicated to the City in a letter dated March 19, 2008, a copy of which is attached.

The California Department of Transportation (Department), Audits and Investigations (A&I) Division will not begin another audit of the City's ICRPs until the errors discussed below are corrected and the City re-submits complete packages for FYs 2004/05, 2005/06, 2006/07, and 2007/08 in compliance with 2 CFR, Part 225. If the City chooses to re-submit the ICAPs, please ensure the information requested in the March 19, 2008, letter is also included with each year's submittal. Once all FYs are received and determined to be in compliance, your ICRP requests will be placed in the A&I audit queue.

This letter will also serve as notification to the City, the Federal Highway Administration, and the Department's Program and District Offices that the City is not authorized to charge FY 2004/05, FY 2005/06, FY 2006/07, and FY 2007/08 indirect costs to any federal or State funded project.

**Unsupported Direct Labor Data and Questionable Methodology for Direct Labor Base**

The direct labor remains unsupported in FY 2004/05, FY 2005/06, FY 2006/07, and FY 2007/08 of the Engineering Services and Traffic Engineering ICRPs. We found the Staff Utilization Report (SUR) did not agree to the Personnel Analysis (PA) report and the City did

not provide explanation for the differences. These reports are used to determine the ICRP allocation base of direct salaries and benefits. Specifically we found:

- There are more employees listed on the PA than on the SUR. For example, in FY 2004/05 there are 68 staff on the PA, but only 52 staff on the SUR.
- Differences between the chargeable percentages listed on the SUR and those used in the PA.
- The PA included the salary of vacant positions which were not listed on the SUR.
- The SUR contained employees who were duplicated in the same report.
- Full time salaries were used on the PA report for employees who worked less than full-time.
- There are variances between employee job classifications listed on the SUR and PA reports.

In addition, the methodology for the direct labor base remains questionable. The SUR records the actual hours worked by employee, including total productive hours and chargeable hours. By dividing an employee's chargeable hours into total productive hours, a direct labor percentage is derived for each employee. The direct labor percentage is then multiplied by the budgeted annual wages for the employee's position or job classification on the PA. The PA is used to calculate the direct and indirect percentages applied to the actual salaries in the ICRP. We noted instances where the budgeted annual wage amount was included for vacant positions when calculating the direct/indirect labor split. In the majority of these instances, the greater proportion of wage is considered indirect, thereby inflating the indirect cost pool. The City did not provide an explanation for why actual individual salaries are not used.

In our prior audit work, we noted the SUR data did not reconcile to individual employee timesheets. In order for A&I to rely on the data presented in the SUR, the City needs to document the reconciliation between timesheets and the report.

#### Unallowable Expenses Included in the Indirect Cost Pools

From prior audit work, we identified the inclusion of unallowable equipment costs in various cost pools. Our current audit noted the City adjusted for some, but not all, of the unallowed costs. For example, \$20,965 for replacement vehicles is included in the FY 2004/05 Engineering Services indirect cost pool, \$55,008 for drafting equipment is included in the FY 2005/06 Engineering Services indirect pool, and \$12,581 for computer hardware is included in the FY 2005/06 Traffic Engineering indirect cost pool. These unallowable costs materially affect the indirect cost rates. Additionally, we also identified other unallowable costs included in the indirect cost pools. Among these were facility maintenance costs to install receptacles for holiday decorations, and food items.

#### Non-compliant Certifications and mathematical errors

We noted that all the City's ICRPs were signed by the Director of Transportation. Per 2 CFR 225, Appendix A, section H.1, indirect cost rates must be certified and the certificate must be

signed by an individual at a management level no lower than the Chief Financial Officer. We also found mathematical errors in the computation of the FY 2005/06 Engineering Services ICRP.

If you have any further questions regarding this letter, please feel free to contact Amada Maenpaa, Audit Manager, at (916) 323-7868, or me at (916) 323-7105.

MARYANN CAMPBELL-SMITH  
Chief, External Audits – Local Governments

Attachment

- c: Brenda Bryant, Director, Financial Services, Federal Highway Administration
- Sue Kiser, Director, Planning and Right of Way, Federal Highway Administration
- James Ogbonna, Senior Transportation Planner, Division of Mass Transportation
- David Saia, Senior Transportation Engineer, Policy Development and Quality Assurance, Division of Local Assistance
- Jenny N. Tran, Associate Accounting Analyst, Local Assistance Accounting Branch, Division of Accounting
- Nicholas Theocharides, Engineering Services Manager, City of Sacramento
- April Lu, Senior Accountant Auditor, City of Sacramento

## DEPARTMENT OF TRANSPORTATION

ATTACHMENT

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March 19, 2008

Jerry Way, Director  
City of Sacramento  
Department of Transportation  
915 I Street, Room 2000  
Sacramento, CA 95814-2064

Re: Fiscal Year 2004/05 and 2005/06 Indirect Cost Rate Proposals

Dear Mr. Way:

This letter is to inform you that the Department of Transportation's Audits and Investigations (A&I) Division is suspending review of the City of Sacramento's Engineering Services Division (City) indirect cost rate proposals (ICRP) for fiscal years 2004/05 and 2005/06. The reason for this decision is three-fold.

First, the City proposed a single rate for its entire Engineering Services Division deviating from its established practice of having separate rates for its Project Delivery (PD) and Traffic Engineering (TE) organizations. As a result of the City's reorganization effective July 1, 2004, TE and PD are now included in a single division and City staff stated that this reorganization helped to better integrate TE in the project delivery process. Although TE may be involved in various stages of the project delivery process, the City has not provided sufficient evidence to show that project delivery is its major function. Based on a review of indirect costs incurred for these two organizations, the major activities performed by the organizations, and applicable sections of the Office of Management and Budget (OMB) Circular A-87, A&I determined that the indirect costs benefit the two organizations to varying degrees and the costs should be accumulated separately. If the City believes a single rate is appropriate for the entire Engineering Services Division, it must provide additional evidence to sufficiently support its assertion.

Second, there are a number of unresolved discrepancies between the proposed ICRPs and the supporting documentation provided by the City. Although City staff have been cooperative and responsive to A&I's requests for supporting documentation, certain methodologies and discrepancies remain unresolved. For example, the data listed on time sheets could not be tied to the various labor reports, which are used to determine the percentage of direct and indirect labor costs and reported in the indirect cost schedule. It should also be noted that the City changed its methodology for accounting of direct and indirect labor costs from previous years. The City has also provided a number of different versions of similar data and it is unclear which data are to be used. Because of these discrepancies and changes in methodology, we could not complete the testing of the labor costs. Similarly, our testing of a

reimbursement request could not reconcile the amount of reimbursement to supporting documentation. In December 2007 A&I requested that the City explain how the reimbursement amount is determined from the documentation provided, but to date this information has not been provided. In addition to the change in methodology for tracking direct and indirect labor costs, the base for allocating indirect costs from the 2005/06 indirect cost pool also changed significantly and the reasoning for the change is unclear. Further, the City proposed including Department and City-wide allocated costs in its ICRPs. In years past, these costs were excluded due to lack of supporting documentation. Through our limited review of these costs, A&I found the City was unable to sufficiently support the allocated costs and allocation methodologies.

Third, the ICRPs cannot be approved as submitted due to the inclusion of unallowable costs in the indirect cost pools. For example, we found a significant amount of capital expenditures included in the indirect cost pools.

The City may resubmit revised ICRPs to address A&I's recommendation for separate rates for the PD and TE organizations, or resubmit revised ICRPs for a single rate along with sufficient evidence to support the appropriateness of a single rate. In either case, the revised ICRPs should be cross-referenced and reconciled to the financial data upon which the rate is based, and exclude unallowable costs.

If you have any questions or concerns, please contact Amada Maenpaa, Audit Supervisor, at (916) 323-7868 or Teresa Greisen, Audit Manager at (916) 323-7910.

Sincerely,

MARYANN CAMPBELL-SMITH  
Chief, External Audits

- c: Nicholas Theocharides, Manager Engineering Services Division, City of Sacramento
- Dean Fujimoto, Supervising Financial Analyst, City of Sacramento
- April Lu, Senior Accountant Auditor, City of Sacramento
- Phil Scott, Division of Right of Way
- Ben J. Bramer, District 3
- Brenda Bryant, Federal Highway Administration
- Gary Buckhammer, HQ Accounting